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SUBJECT: FINANCE MINISTER VISION FOR GOF MACRO-ECONOMIC
POLICY

REF: PARIS 001050

1. SUMMARY. Just before turning in his resignation (septel), Finance Minister Herve Gaymard announced the details of GOF macro-economic policy in the run-up to presidential elections in 2007. He planned a series of fiscal incentives and reforms aimed at restoring confidence, boosting economic growth and stimulating job creation. Job creation has become particularly significant, as the latest statistics show French unemployment has reached the symbolically significant 10 percent mark. The ambitious GOF policy direction is likely to continue, no matter who occupies the Minister's post in the future. END SUMMARY.

Confidence: Key to Economic Growth and Employment

2. Once comfortably settled in his job, Finance Minister Herve Gaymard decided to set out the GOF vision for macroeconomic policy for the rest of President Chirac's current term. On February 8, Gaymard held a press conference with his entire team, Industry Minister Patrick Devedjian, Foreign Trade Minister Francois Loos and Budget Minister Jean-Francois Cope to explain the GOF policy direction. Gaymard, faithful to "the positive attitude" so dear to Prime Minister Raffarin, deemed 2004 GDP growth performance as "excellent" (ref). He spoke of the GOF's determination to achieve 2.5% GDP growth in 2005, although he affirmed that there could be "no employment without growth, no growth without confidence, and no confidence without employment." He expressed dissatisfaction with French "inability to deal with a certain number of structural obstacles in our economy." Thus, the two main features of GOF macroeconomic policy continue to be containing the deficit below 3 percent of GDP, and using fiscal measures to stimulate consumption, purchasing power, business activity, and reduce unemployment.

GOF Policy Details: Stimulating Consumption

5. Gaymard was building upon initiatives introduced by his predecessor Nicolas Sarkozy, to boost consumer confidence, purchasing power and employment:

A. Resuming income tax cuts in 2006 and 2007 in line with President Chirac's promise to cut them by 30% by the end of his mandate in 2007. Gaymard says he will make a number of proposals to Prime Minister Jean-Raffarin, focusing particularly on tax cuts for the middle-class and the working population, and an improvement in the tax deduction related to general expenses of the self-employed.

B. Extending the period for tax deductions on gifts to descendants to December 2005, and raising eligible amounts for deductions to 30,000 euros from 20,000 euros. The idea is to recycle a portion of savings in consumption and investment.

C. Making Housing More Accessible by:

--Liberalizing home loans to enable people to re-mortgage real estate and raise cash more easily. Gaymard wants to reactivate by the end of 2005, two "Anglo-Saxon" schemes that former Budget Minister Dominique Bussereau planned to launch in early 2005: renewable mortgages ("hypothèque rechargeable") and loans associated with mortgages with a life annuity ("viager hypothecaire").

--Moderating rent increases by creating, by 2006, a new index ("indice de gestion locative") that will replace the cost of construction index (ICC) used since 1953 in the annual revision of rent increases. Gaymard explained that using the ICC was unfair since it has increased significantly in the past few years (4.58% in Q-3 2004 compared with Q-3 2003, one of the highest increases since

1995), and has been significantly higher than the real estate maintenance cost.

--Improving the housing market supply. In a move to reassure landlords, the GOF wants to encourage insurance companies to propose real estate insurance contracts with options to cover the risk for unpaid rents. Insurance premiums of these contracts could be topped up by a surcharge in case of unpaid rents.

1D. Authorizing payment of interest on current banking accounts in line with the European Justice Court's decision, as early as March 2005. Banks are requesting as counterpart that clients pay for all bank services (including the use of checks, which currently are provided free of charge). Gaymard promised to make sure that banks reinforce the transparency of their services costs.

1E. Encouraging responsively the development of a consumer credit industry including credit to students, as "France has to catch up with other countries."

1F. Liberalizing the retail market with an ambitious reform of the "Loi Galland" before the end of the year. Sarkozy had made this reform a priority of his own program. Many observers deem that the law that bans retailers from selling branded goods below suppliers' list prices is a cause for significant consumer price increases.

----- Stimulating Purchasing Power and Activity of Companies -----

16. The GOF also wants to stimulate purchasing power and activity of companies by:

1A. Cutting further payroll taxes paid by employers. The "level zero" will be achieved on the minimum wage (SMIC) in 2006 when employers benefit from payroll taxes cuts equivalent to 28% of gross payroll expenses (versus 26% currently).

1B. Accelerating repayments of value added tax to companies. The GOF committed to return 80 percent of VAT repayments to companies within a month, by the end of 2005. About 33 billion euros will be re-injected in companies earlier-than-expected. Electronic communication will help simplifying relations of companies with the tax administration, notably by allowing companies to deduct VAT repayments from tax bills they owe to administrations.

1C. Facilitating the access of small- and medium-sized companies to bank credit by limiting banks' responsibility to loans. In the current system, banks may refuse to make loans when they deem, rightly or wrongly, it is risky because they may be accused of "excessive support."

1D. Facilitating the access of small- and medium-sized companies to financial markets to have their plans funded. Without this access, corporate plans fail and result in less economic growth and fewer jobs for the French economy. The GOF plans to develop the "love money," (funds from affective, family, geographic or professional sources) by implementing new regulations. Gaymard also asked banker Rene Barbier De La Serre to propose reforms to re-orientate savings towards "active" savings (in a "anglo-saxon" mode) by providing tax incentives to regular holders of equities (by opposition to speculators).

----- Encouraging Exports and Adjusting Industrial Policy -----

17. Loos and Devedjian stressed that exports and industry were keys for economic growth and job creation.

1A. Encouraging exports, by stimulating energy of "France's team" with the creation of UbiFrance, a new agency for international development of companies. Notably, the GOF intends to involve small- and medium-sized companies in the expansion of exports. Regional councils ("Conseils Regionaux") can associate with that expansion, on an experimental basis. Candidates to the experiment will benefit from Paris-based foreign trade specialists' expertise and government funds they manage. The second axis of the GOF strategy is to encourage canvassing of business abroad by enhancing tax relief on professional expenses of commercial executives working abroad, having a sector/country approach, encouraging canvassing in Germany (France's first trading partner) and China (emerging economic power), increasing guarantee insurances, and providing financial aid through export credit agency COFACE to French firms established abroad when they promote French goods.

1B. Improving France's attractiveness by attracting decision

and research centers along with their staff in France, notably though favorable tax treatment.

1C. Adjusting industrial policy by defining the impact of macro-economic policy on industrial sectors, taking into account criteria such as exposure of sectors to competition, labor shortage, and sensitivity to regulatory schemes. Around 10 industrial sector clusters will be created with the purpose to coordinate action between industry and administration. Devedjian emphasized that the GOF has a real industrial policy in relation with company and consumer interests.

1D. Stimulating further innovation, a key factor of France's competitiveness. A new Agency for Industrial Innovation will analyze forces and weaknesses of the French industry, and will attribute repayable advances in support of federative projects under control of large industrial groups.

----- Tackling Unemployment through Specific Measures -----

18. Gaymard stated that "what really matters", is the fight against "scandalously high" jobless rate (9.9% on average corresponding to 9% for the elderly and 21.8% for the youth). "We can't behave as if we didn't have twice the unemployment of some other European countries. We must question ourselves about the success of the U.K., Denmark or Sweden. We must be pragmatic and have no taboos." Gaymard hopes that the Council of Job Orientation, which is in the process to be created, will allow politicians, experts, employees and employers representatives to speak the same language about unemployment. Implicitly acknowledging that economic growth and further cuts in payroll taxes will not be sufficient to stimulate job creation, Gaymard pledged to:

1A. Increase the earned income tax credit in 2006 "to have work pay better than welfare." The income tax credit will be increased for part-time employees. An exceptional tax credit will reward the unemployed who will accept to work in sectors with labor shortage.

1B. Improve labor flexibility by going beyond a reform now passed by the Parliament to soften the 35-hour workweek.

19. Gaymard repeated that he has been working closely with Labor and Social Cohesion Minister Jean-Louis Borloo to achieve Prime Minister Jean-Pierre Raffarin's objective to cut unemployment by 10% by the end of 2006. Economic growth and measures to spur job creation including the Social Cohesion Plan are expected to create 250,000 jobs in 2005, and more in 2006. In a new more flexible approach to encourage employment of part-time and lower-skilled employees, Borloo recently unveiled a plan to create up to 500,000 new jobs in the services sector in the next three years. Under this plan, tax cuts will encourage households to employ care workers and domestic staff. The GOF is also working on plans to simplify the French complex labor code.

----- Restoring Confidence by Reducing the Budget Deficit -----

110. Budget Minister Cope confirmed that the 2004 budget deficit was expected to amount to 3.6% of GDP, reiterating with Gaymard that the 2005 budget deficit would fall below 3% of GDP as promised to the European Commission. "The need to control public finances is not an obsession of accountancy imposed by Europe. It is straightforward common sense, when one considers that a French child, when born, arrives in the world with 17,000 euros of debt, and that since 1981, our public debt has risen 22% to 65% of GDP." Increasing debt also means anticipations for repayments and needs for budget receipts, thus increased taxes, a process that harms confidence in the future. Gaymard indicated that, in 2006, the rule was still no growth in central government budget spending (excluding inflation), "in line with decision made by Raffarin" to reduce the budget deficit. Regarding the social security system, Gaymard said that the health insurance reform will help, but it was up to the French to preserve "an extremely precious asset." He also made clear that the GOF would pay for transfer of expenditures from the central government to local authorities, estimating expenditures related to decentralization at 3% of local authorities' expenditures.

----- Privatizing Companies -----

111. Gaymard also vowed to press ahead with the partial privatization of three major energy firms (power and gas utilities EDF and GDF, and the nuclear group Areva) and a road operator SANEF ("Societe des Autouroutes du Nord et de

l'Est"). Plans include privatization of SANEF by April 2005, GDF by the summer, Areva by the end of the summer, and EDF by the end of the year.

Comment

12. The GOF macro-economic policy, announced just after the G7 Finance Ministers meeting, is an ambitious plan to address France's economic problems. However, many measures still would have had to be discussed with Ministers for Education, Labor, and Small- and Medium-Sized Companies or with sector representatives (banks or businesses), examined by the Parliament as part of the central government budget, or introduced as separate regulations. Gaymard's resignation (septel) will make that discussion problematic, but will also make it difficult for any successor to significantly change France's economic policy direction.
WOLFF